Legislation Details (With Text)

File #:	21-1211 **Version:** 1		
Type:	Report	**Status:**	Filed
File created:	9/13/2021	**In control:**	City Council
On agenda:	9/21/2021	**Final action:**	9/21/2021
Title:	Receive the September 2021 Financial Report and reaffirm the current revenue diversification model and financial principles in advance of the 2022 budget workshops		
Sponsors:			
Indexes:			
Code sections:			
Attachments:			

Date	Ver.	Action By	Action	Result
9/21/2021	1	City Council	received	

CITY COUNCIL AGENDA ITEM

ACTION REQUESTED:
Receive the September 2021 Financial Report and reaffirm the current revenue diversification model and financial principles in advance of the 2022 budget workshops

DEPARTMENT: Finance Department

SUBMITTED BY: Rachel Mayer, Finance Director

BOARD/COMMISSION REVIEW:
N/A

BACKGROUND:
The monthly financial report, developed in response to the COVID-19 pandemic, provides timely information and data related to the City's financial position and the local economy. The September report provides a brief overview of current revenue and expense trends; however, the primary focus is a review of the financial principles that guide the City's financial management strategies and their status heading into the 2022 budget season.

DISCUSSION:

Economic Indicators

The emergence of COVID-19 variants has raised new public health concerns. Staff is closely monitoring the economic landscape for potential impacts; however, at this time, all business sectors are operating without restrictions beyond the required use of face coverings.

Revenues

State collected revenues performed well through August. Actual revenues exceed budget projections by 20%, or $9.4 million, year-to-date. Strong returns continue in sales tax, home rule sales tax

(HRST), and state income tax. Year-to-date revenues are up 17%, 14%, and 42%, respectively, compared to budget projections. Motor fuel tax remained stable and is 1.6% ahead of projections for the year. Use tax continues to decline in favor of higher sales tax but remains 9.5% above projections.

In August, the City updated its online submission process for local taxes and staff is working to align reporting with this new process. Initial estimates show food and beverage sales exceeded $40 million for the third consecutive month in July. Real estate sales also remained strong at $186 million in July and $208 million in August.

Expenses
Staff continues to closely watch for negative impacts related to inflation and supply chain disruptions. Price increases have been seen in some materials, such as electric warehouse supplies and several change orders have been processed on vehicle awards resulting in minor cost increases. Because the City's largest expense categories (salary/benefits, electric, and water) are not subject to rapid price fluctuations, the overall budget has been largely unaffected by inflationary price increases in 2021.

Financial Principles
Prior to the start of the 2022 budget workshops, staff believes it is appropriate to review past Council actions that have guided the City's financial management strategies up to this point.

Following decades of rapid growth beginning in the 1980s, Naperville's transition to a maintenance community resulted in waning revenue streams once fueled by development. By 2015, the City was experiencing depleted cash reserves and increased reliance on borrowing for infrastructure maintenance projects.

Working together in response to this trend, in 2015 and 2016 the City Council developed and passed a financial strategy that put the City on a path to long-term financial stability. Understanding that any future growth would involve limited infill versus expansion and that assets developed in the growth phase would require more extensive maintenance in the coming decades as they age, that strategy included adopting three financial principles as a set of strategic guidelines.

Since their adoption, these principles have guided the City's financial planning and budgeting and financial decisions have consistently tested against them. The impact of the City's active financial management is seen in its rising cash balances, decreasing debt, and reaffirmation of the City's AAA credit rating by both Moody's and Standard & Poor's in 2018 and 2020. Below is a recap of each principle five years post-adoption.

Principle #1: The City will pass a structurally balanced operating budget annually.

The City has consistently developed and adhered to a balanced General Fund budget, which is the primary operating account that supports core City services such as police, fire, public works and community services, as well as the associated backend functions and resources necessary to deliver those services effectively and efficiently.

In each of the past five years, General Fund expenses were budgeted in line with projected revenues and actual expenses for those years came in at or below budget. (In 2019, the City Council amended the budget upwards by $274,000 to improve leaf collection services, which created a slight

imbalance; however, stronger-than-expected revenues made that a non-factor by year-end.)

	Budget			Actual		
Year	**Revenue**	**Expenses**	**Difference**	**Revenue**	**Expenses**	**Difference**
2017	122.13	121.95	0.17	121.87	119.86	2.01
2018	121.29	121.28	0.01	120.27	120.43	(0.16)
2019	125.93	126.15*	(0.22)	129.32	123.55	5.77
2020	125.33	125.25	0.08	127.12	123.44	3.68
2021	130.29	130.29	0.00	-	-	-
Budget amended mid-year to enhance leaf collection services; $ in millions						

Part of the success in this area over the past five years is due to the City's continued emphasis on revenue diversification to avoid overreliance on any one funding source. Naperville's revenue mix, including service charges, market-driven taxes, intergovernmental taxes, and other sources, has remained consistent and been regularly tested against the concepts of consistency, competitive advantage, service alignment and diversification.

Principle #3: The City will actively seek to increase its reserves to twenty five percent (25%) and reduce its debt by twenty five percent (25%) in the next eight (8) years.

Cash reserves have grown steadily since 2016 across various City funds, increasing from $71.1 million to $164.8 million by the end of 2020. Over that period, cash balances have improved across all three major operating funds: the General Fund, the Electric Utility Fund, and the Water Utilities Fund. Cash balances have also improved in the capital and debt service funds.

Principle #3 specifically addresses increasing General Fund cash reserves to 25% of expenditures. General Fund reserves increased from $15.5 million in 2016 to $30.2 million in 2020. The City maintains a 20% emergency reserve policy for the General Fund, excluding transfers to pension funds and inter-fund transfers. The table below shows year-over-year growth in the General Fund cash balance as a percentage of total expenditures, which goes above and beyond current policy. The City is currently on track to meet the established cash reserve goal.

Year	**General Fund Cash Balance**	**% of Total Expenditures**
2016	15.5	13.0%
2017	19.8	16.5%
2018	22.1	18.4%
2019	25.1	20.3%
2020	30.2	24.4%
$ in millions		

The City maintains debt positions across several funds. Principle #3 addresses reducing debt funded through the property tax levy and not by other sources, such as the utility funds, by 25% in the eight years after its passage. At the end of 2014, the City held $121.3 million in debt in this category. That amount has steadily decreased since 2016, due in part to the passage of the HRST.

powered by Legistar™

The City assumed additional debt in 2020 when funding for capital projects remained uncertain in the wake of the pandemic. This increase will not dramatically impact the City's ability to achieve its goal as no debt issuance is planned for 2021. The City remains on track to reduce debt by 25% by the end of 2022.

Year	Debt Service	% Reduction
End 2014	121.3	-
End 2015	108.9	-10.1%
End 2016	104.7	-13.7%
End 2017	101.7	-16.1%
End 2018	95.9	-20.9%
End 2019	88.9	-26.7%
End 2020	101.4	-16.4%
End 2021	89.4	-26.3%
End 2022 (P)	89.4	-26.3%
$ in millions		

A broader look at the City's debt position over the past five years shows a steady reduction in total debt, which includes enterprise debt related to the City's utilities. Over that period, utility-related debt has declined by 45%. As the City's total debt decreased, the equalized assessed valuation (EAV) of property in the City continued to rise. This has further reduced the debt burden on individual taxpayers. This can be seen through the measure of debt as a percentage of EAV, which has declined from 3.0% in 2016 to 1.9% in 2020.

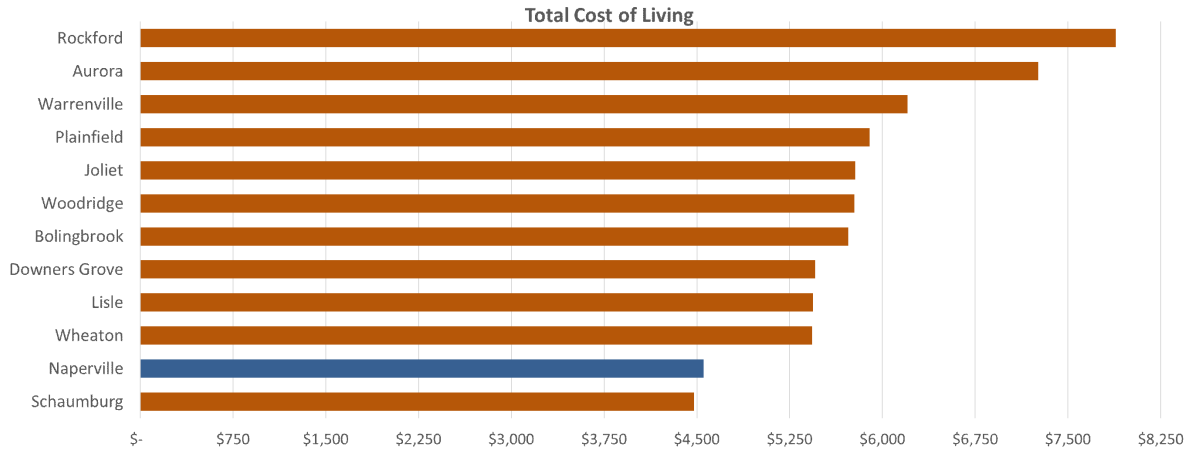
Principle #2: The City commits to continuous improvement in the delivery of necessary and cost effective services.

While more challenging than other principles to quantify, Principle #2's impact over the past five years can be measured through efforts in advancing emerging priorities, the City's response to the pandemic, and the continued value provided to taxpayers compared to other municipalities in the region.

Naperville's approach to municipal service has been to not just serve the community, but to serve it *well*. Since 2016, using data-driven approaches as well as the need to respond to changing societal priorities, staff has enhanced this service model. This includes the hiring of a DE&I Manager and Sustainability Coordinator, improved staffing in IT to support the City's technology assets, and supporting needed service enhancements, among others. For example, when data showed that Finance call center wait times had reached almost 12 minutes in 2018, two positions were added to the 2019 budget, resulting in a reduction of nearly 10 minutes in wait times by the end of 2020. Another example is the approval of four police officer positions in the 2020 budget in association with the creation of a Strategic Response Unit to respond to targeted concerns based on crime analytics. Since its inception, the unit has engaged in over 2,500 proactive encounters, participated in numerous resident and business stakeholder meetings, and seized approximately 30 illegal firearms.

Naperville's financial framework, as shown by the success of Principles #1 and 3, has addressed the

long-term financial issues the City experienced in the mid-2010s. Following the principles over the past five years was critical to leading the City through the initial months of the pandemic. According to Illinois Municipal League data, many municipalities reduced services, drew down reserve funds, closed facilities, or increased taxes and fees in response. However, Naperville maintained all its services and even enhanced some online offerings. This was possible because of our financial flexibility and revenue diversification model. Throughout the pandemic, the City maintained one of the lowest costs of living among comparable communities, as seen below.



Of note is that the additional quarter percent HRST added in 2018 was critical to meeting Principle #3's debt goal in 2021. Since 2016, the HRST has paid down $12.2 million in debt service while contributing $41.2 million to capital projects. Maintaining the HRST is a key component to future investment in capital assets without significantly adding debt. Additionally, there is no data showing the quarter percent diminished spending in Naperville or impacted consumer patterns. In fact, the community's financial and consumer strength continues to be a draw for national businesses, including Costco, Amazon, and Nike. Among the City's neighboring and comparable home rule communities, Naperville shares the lowest HRST rate.

2022 Budget Assumptions and Council Affirmations

While the idea of doing more with less was normalized in local government in the cautious post-Great Recession era of the 2010s, Principle #2 and the City's solidified financial position serve as a starting point for proactively optimizing levels of service delivery in the post-pandemic era.

Staff believes that there are now opportunities to leverage the City's financial stability in a way that provides a more proactive approach to both enhancing fundamental City services as well as looking ahead to innovative approaches that meet post-pandemic needs such as increased reliance on technology to serve operational departments. This can include investments in continuing efforts from the 2021 budget, such as DE&I and sustainability, along with anticipating the costs of core services that experience changes year-over-year.

To strategically allocate resources in the 2022 budget in alignment with Principle #2, staff requests the following be affirmed by the Council in advance of the budget workshops:

- Reaffirm the revenue diversification mix at current levels as will be discussed in the Council presentation; and
- Reaffirm the financial principles as the continued financial policy framework for the City.

In addition, staff requests that any priorities the Council would like included in the 2022 budget - similar to the beautification request made at the August 17 meeting - be discussed at the September 21 meeting. This level of input from Council has significant value when it is received early in the budget process so staff can consider it alongside all other budget requests.

FISCAL IMPACT:
N/A